

A Work Project, presented as part of the requirements for the Award of a Master Degree in Finance from the
NOVA – School of Business and Economics.

Is China the future market of Adidas

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A Project carried out on the Master in Finance Program, under the supervision of:

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5. January 2020

Abstract

In the following report a certain issue which could have an impact on Adidas' valuation outcome and which I recognized while doing the Equity research is briefly addressed. The aim of the report is to understand whether China is really the future market of Adidas and if Adidas' market share in this market could continue to grow at double-digit rates projected in the main report. In the first part of the report a short overview of Chinese sportswear industry and its trends is given. In the next step, a detailed SWOT analysis of Adidas position in China was conducted in order to better understand possible future scenarios. After identifying the main strengths, weaknesses, opportunities and threats, I presented a scenario analysis with 3 cases: base case, best case, worst case. Based on the outcome of the scenario analysis, and obtained share prices, I concluded that Adidas may be undervalued by the market as the share price calculated in all 3 scenarios was higher than the Adidas' current share price of EUR 273

Keywords

- Adidas AG
- Chinese sportswear industry
- SWOT Analysis
- Scenario Analysis

IS CHINA THE FUTURE MARKET OF ADIDAS

INDIVIDUAL REPORT

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Overview of Chinese sportswear industry

Between 2015 and 2018 the sportswear market in China reported double digit growth, compared to North America and Europe, which grew at the single digit rates (**Exhibit 1**). In 2018, the sportswear market in China reached size of EUR 40 billion and is expected to reach EUR 78 billion by 2025, rising at the CAGR of 10.2%.¹ In order to determine Adidas' outlook in the Chinese market, a detailed SWOT analysis is conducted.

Exhibit 1: Sportswear industry- growth in % between 2015 and 2018

| Sportswear market growth | 2015A | 2016A | 2017A | 2018A |
|--------------------------|-------|-------|-------|-------|
| Western Europe | 2,1% | 2,6% | 2,7% | 2,9% |
| North America | 7,2% | 5,5% | 5,8% | 7,4% |
| Greater China | 12,5% | 14,1% | 16,3% | 19,5% |

Source: Euromonitor Passport

SWOT Analysis

Strengths:

- **Powerful brand image** - in China, Adidas is perceived as a premium brand with fashionable and high-quality products. Thus, the company can benefit from premium prices for its products. For example, the limited edition of Yeezy shoes was extremely successful in China, even though the price was above EUR 200.²
- **Strong financial position** - Since 2010, Adidas' sales in China have tripled. In 2018, Adidas generated revenue of EUR 21,195 million (EUR 4,061 million in China). Also,

¹ Passport – Euromonitor International (2019, April). *Sportswear in China*. Retrieved on 18th December from <https://fesrvsd.fe.unl.pt:2129/portal/Analysis/Tab>

² Ren, D. (2019, April 2nd). "How Adidas captured the hearts of Chinese millennials with the Yeezy shoe". Retrieved on 20th December from <https://www.scmp.com/business/companies/article/3004195/theyre-not-your-dads-trainers-how-adidas-captured-hearts-chinese>

the company has 12,000 stores in 1,200 cities nationwide. Thus, Adidas is able to invest large amounts in new technologies, stores and innovative products, which will increase company's presence and attract more customers.³

- **Partnerships** - Adidas is working closely with Chinese ministry of education. The company will provide training for more than 50,000 sports teachers from China, who are supposed to teach soccer to Chinese kids and teenagers increasing Adidas' brand awareness. Also, Adidas has entered into partnership with Alibaba, one of the largest e-commerce companies, to sell its shoes on Alibaba's online marketplace Tmall.⁴

Weaknesses:

- **Local know-how** - Compared to Adidas, domestic brands can benefit a lot from local know-how. They understand better the culture, technology, traditions and people's habits. Therefore, local companies are able to develop better strategies on how to approach Chinese customers, who are perceived as a demanding sort of customers.⁵
- **Premium price range** - Innovative products and premium prices make Adidas' products only available to the limited number of customers.
- **Narrow product focus** - Adidas comprises only two brands, adidas and Reebok, which offer products for doing regular sports and everyday life. However, there is still a lot of place to extend the offer for other activities such as skiing, where domestic brand Anta is slowly taking over the market.

Opportunities:

Besides growing population, growing middle class and higher levels of disposable

³Zhuoqiong, W. (2019, May 21st). "Adidas eyes China expansion". Retrieved on 22nd December from <https://www.chinadaily.com.cn/a/201905/21/WS5ce359e8a3104842260bcd7a.html>

⁴Sillitoe, B. (2019, February 25th). "Adidas strengthens ties with Alibaba for continued China push". Retrieved on 22nd December from <https://www.essentialretail.com/news/adidas-and-alibaba-continued-china/>

⁵Zheng, K. (2019, May 2nd). "Chinese Sportswear Market: Watch out, Nike & Adidas!". Retrieved on 22nd December from <https://www.sportswear-international.com/news/stories/Guest-Comment-Chinese-Sportswear-Market-Watch-out-Nike--Adidas-14642>

income, main opportunities identified in the Chinese market are:

- **Government investments** - the China's national government is actively investing large amounts of money in sports infrastructure. The aim of Chinese President Xi Jinping is to make China soccer superpower by 2050. Additionally, the government's goal is to have the largest sports economy in the world, amounting to EUR 762 billion by 2025. The current plan includes among others the construction of 70,000 soccer fields by 2020, launch the national fitness plan to beat diabetes and obesity, construction of 1,000 ski resorts and 240 ski slopes.^{6&7}
- **Increased sports participation rates** - 36% of urban population in China is doing sports regularly.⁸ The interest has mainly grown for sports such as football, basketball and running. Currently, there are more than 300 million basketball players in China and more than 305 million soccer fans from China⁹. In 2018, 5 billion people participated in marathons, an increase of 17% compared to 2017. In the same year, 1,581 marathons were held up from 22 in 2011.¹⁰
- **Athleisure trend** -The influence of Western culture, social media and "selfie-trend" has driven athleisure trend in China. By posting videos and photos in fashionable sportswear on social media, the pressure to keep up with the trend and wear sports clothing not just while working out but also in more formal occasions, increased in China.

⁶Zhao, M. (2017, October 13.). "Rise of China's sports industry boosts activewear brands". Retrieved on 23rd December from: <https://www.spglobal.com/marketintelligence/en/news-insights/trending/6k5vgofopqfhd1ptfxeetw2>

⁷Coresight Research (2018). *China's Sportswear Market*. Retrieved on 23rd December from <https://www.azoyagroup.com/blog/index/view/chinas-sportswear-market/>

⁸Williams, R. (2019, March 28th). "Growing opportunities for sports brands in China". Retrieved on December 25th from <https://blog.redpoints.com/en/growing-opportunities-for-sports-brands-in-china>

⁹Upton, P. (2019, September 25th). "Opportunity for Big Growth in China's Sports Industry". Retrieved on 24th December from <https://www.china-briefing.com/news/opportunity-big-growth-chinas-sports-industry/>

¹⁰The Telegraph (2019, January 17). "How reforms to China's sports industry have led to a healthier society". Retrieved on 24th December from <https://www.telegraph.co.uk/peoples-daily-online/sport/sports-reforms/>

Threats:

- **Domestic competition** - Nowadays, Chinese domestic brands like Anta Sport and Li-Ning represent a real treat to Nike and Adidas. Anta is the third largest market player in China with market share of 14.9% up from 8% in 2017, whose revenues increased by 44.4% to EUR 3 billion between 2017 and 2018. The Group has 12,479 stores, thereof 1,788 being Fila stores. Besides strong financial performance and high presence, Anta has partnered with Coca-Cola, aiming to launch a line of creative and innovative sportswear products, and with Frozen, children's animation movie, aiming to launch new kids' collection.¹¹ Moreover, in 2019 Anta Group purchased Amer Sport, finish sportswear manufacturer, and has partnered with Japanese ski brand Descente to strengthen its position in the ski segment due to upcoming Winter Olympic Games. Additionally, Anta was also selected to manufacture apparel for Beijing 2022 Olympic and Paralympic Winter Games. Li-Ning Sports Goods is considered to be top growing apparel company in terms of stock market gains. In 2019, the price of stock soared 200%, outpacing Nike and Adidas.¹²
- **Cultural shift** - People in China are starting to be more into "patriotic tourism" and "patriotic spending". This trend is driven by several reasons such as government tax cuts in China, aimed at increasing mainland consumptions and global influence of Chinese domestic brands and by the fact that domestic brands are, nowadays, perceived as good as international ones. As a result, higher percentage of people is willing to give domestic brands a go and feels proud to be Chinese. Thus, 19% of the Chinese

¹¹Zhuoqiong, W. (2019, September 10th). "Anta Sports delivers strong first-half results". Retrieved on December 26th from: <https://www.chinadaily.com.cn/a/201909/10/WS5d77320ea310cf3e3556ac2e.html>

¹²The fashion law (2019, October 14th). "Chinese sportswear company stock is growing faster than Nike and adidas, Making it the World's hottest Sportswear Brand". Retrieved on 27th December from <https://www.thefashionlaw.com/home/a-chinese-sportswear-companys-stock-is-growing-faster-than-nike-and-adidas>

population is willing to pay more for domestic brand than for international ones, which represents an increase of 4% since 2015. Charlie Chen, researcher at the Credit Suisse said: “Chinese consumer, especially the younger generation, don’t just believe the notion that foreign brands are better. Right now, Chinese consumer think China is good and ‘Made in China’ is not bad at all”.¹³ As a result, after many years Chinese brands were equally rated as international brands in Brand Power Survey.¹⁴

Scenario Analysis

According to DCF model, Adidas’ price per share should be equal to EUR 304. In the worst-case scenario, I assumed that the Chinese will continue to value domestic brands more and more and that Anta Sports and other local brands will be able to take share from Adidas, especially after Olympic Games in 2022. Thus, Adidas’ market share in China will drop to 8% from 2022, instead of projected 10%, resulting in price per share of EUR 284. In the best-case scenario, I assumed that Adidas will be able to further increase its market share in China due to large investments in new products, technologies and stores, collaborations with Chinese government, which will further increase brand awareness among millennials and increase sport participation rates. As a result, Adidas will be able to gain a market share of 12% in 2020 (instead of projected 10.4%), which will then drop and stabilize at the level of 2018, which is equal 11,6% until 2025. The price per share I obtained in the best-case scenario was EUR 323. (**Exhibit 2**). In all 3 cases, the share price obtained is higher than the current share price of Adidas, which is equal to EUR 273, meaning that Adidas may be undervalued by the market.

Exhibit 2: Scenario Analysis

| Greater China | Share price | Shareholder's return | Rating | Market share | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|---------------|-------------|----------------------|--------|--------------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Base Case | 304 | 13,2% | BUY | Base Case | 9,3% | 10,1% | 11,1% | 11,6% | 11,2% | 10,8% | 10,4% | 10,0% | 10,0% | 10,0% | 10,0% |
| Worst Case | 284 | 5,9% | BUY | Worst Case | 9,3% | 10,1% | 11,1% | 11,6% | 11,2% | 10,8% | 10,4% | 10,0% | 8,0% | 8,0% | 8,0% |
| Best Case | 323 | 20% | BUY | Best Case | 9,3% | 10,1% | 11,1% | 11,6% | 11,2% | 12,0% | 12,0% | 11,6% | 11,6% | 11,6% | 11,6% |

Source: Analyst estimates

¹³ Credit Suisse (2019): *Emerging Consumer Survey*. Retrieved on 27th December from <file:///Users/admin/Downloads/csi-emerging-consumer-survey-2019.pdf>

¹⁴ Millward Brown (2015). *Chinese Brands come of age*. Retrieved on 27th December from https://www.millwardbrown.com/docs/default-source/global-brandz-downloads/china/BrandZ_2015_China_Top100_Report_EN.pdf